Shareholder Activism & Engagement 2020

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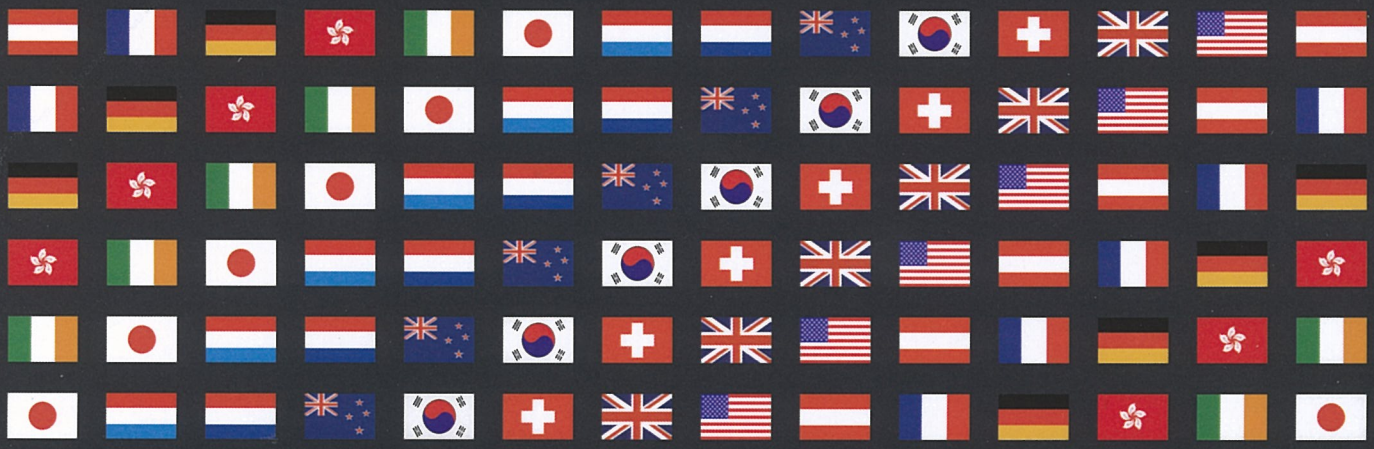

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GENERAL

Primary sources

1 | What are the primary sources of laws and regulations relating to shareholder activism and engagement? Who makes and enforces them?

The primary source of laws and regulations are the Companies Ordinance (Cap. 622) (the Companies Ordinance). Given that listed companies are involved, the Securities and Futures Ordinance (SFO), the Main Board Listing Rules and the GEM Board Listing Rules, and the Codes on Takeovers and Mergers and Share Buy-backs (Takeovers Code) also apply. Unless otherwise specified, references to Listing Rules mean the Main Board Listing Rules.

The current version of the Companies Ordinance was passed by the Hong Kong Legislative Council on 12 July 2012 and came into force on 3 March 2014. Sections 732 and 724 of the Companies Ordinance are particularly relevant to shareholder activism and engagement and apply to both Hong Kong companies and non-Hong Kong companies (defined as a company incorporated outside Hong Kong that has established a place of business in Hong Kong).

The Securities and Futures Ordinance was enacted by the Legislative Council on 13 March 2002 and came into force on 1 April 2003. Part 15 of the SFO, which sets out the laws relating to disclosure of interest (beneficial ownership in the company), is particularly relevant to shareholder activism.

The Listing Rules and the Takeovers Code are made and enacted by the Hong Kong Exchanges and Clearing Limited (HKEx) and the Securities and Futures Commission (SFC) respectively. The Listing Rules are administered and enforced by the Stock Exchange of Hong Kong Limited (Exchange) primarily and the SFC. The Takeovers Code is regulated by the Takeovers Panel, a committee of the SFC.

The Listing Rules apply to matters related to those securities and issuers with securities listed on the Hong Kong stock market whereas the Takeovers Code applies to takeovers offers, merger transactions and share buy-backs affecting public companies in Hong Kong.

The legislation relating to shareholder activism and engagement is supplemented by the Corporate Governance Code and Corporate Governance Report (CG Code) set out in Appendix 14 of the Listing Rules. The provisions in the CG Code are not mandatory and deviations from the provisions are acceptable if listed companies consider there are more suitable ways for it to comply with the principles of the CG Code. Nevertheless, listed companies are expected to comply with the CG Code and must state whether they have complied with the CG Code and the reasons for non-compliance (if any) in their interim reports and annual reports. This is commonly described as the 'comply or explain' approach.

Shareholder activism

2 | How frequent are activist campaigns in your jurisdiction and what are the chances of success?

Despite the increasing prevalence of activist campaigns, there is not sufficient data to deduce the frequency of the activist campaigns in Hong Kong and the chance of success of campaigns. To date, successful activist campaigns in Hong Kong known to the public include the campaign instituted by Passport Special Opportunities Master Fund (Passport) to prohibit a listed company, eSun Holdings Ltd (eSun), from proceeding with its private placement.

On the contrary, BlackRock Inc failed to block G-Resources Group Limited (G-Resources) from selling its crown-jewel gold mine at near book value. PAG Limited's campaign to buy Spring REIT also failed since it only obtained support from 41.5 per cent of Spring REIT's shareholders, falling below the required threshold of 50 per cent.

3 | How is shareholder activism generally viewed in your jurisdiction by the legislature, regulators, institutional and retail shareholders and the general public? Are some industries more or less prone to shareholder activism? Why?

Companies controlled by families or the PRC government (known as state-owned enterprises) are the predominant form of listed companies in Hong Kong. As such, less protection has been accorded to minority shareholders and these companies are hostile to outsiders including shareholder activists generally. Nevertheless, there is continuing growth in shareholder activism and awareness of minority shareholders' protection over the past few years in Hong Kong. More long-term shareholders and institutional investors have become increasingly concerned about the operation and governance of their investee companies. They are of the view that ownership of shares should be accompanied by the right to speak and vote on matters that may affect how a business is run. In this regard, the Securities and Futures Commission (SFC) also published the Principles of Responsible Ownership (Principles) in March 2016, which sets out how investors may meet their ownership responsibilities, such as reporting to the listed company its policies for discharging ownership, monitoring their investee companies and establishing clear policies on when they will escalate their engagement activities. Despite its non-binding and voluntary nature, the Principles will serve the purpose of promoting corporate governance for the protection of shareholders' interests and improving the performance of investee companies and the Hong Kong financial market in the long run.

On 27 July 2018, the HKEx also published the Guidance for Boards and Directors detailing the roles and responsibilities of the directors with a view to promoting good corporate governance among listed corporations.

In July 2018, the Exchange also tightened the Listing Rules relating to capital raising activities by listed issuers that create unfairness to

the minority shareholders. Following the amendments, all open offers require prior approval from the minority shareholder unless the shares are issued under an existing general mandate.

Shareholder activism seems to have become more widespread in all industries. Some companies that have recently been subject to a public activist campaign include Bank of East Asia (bank), G-Resources (a mining company), China Motor Bus (property developer) and Spring REIT (real estate investment trust). There is no traceable pattern showing that the activists are targeting a specific industry. It is anticipated that shareholder activism will become a feature of the corporate landscape in Hong Kong.

4 What are the typical characteristics of shareholder activists in your jurisdiction?

In Hong Kong, the shareholder activists instituting public campaigns are mainly institutional shareholders and short-seller activists.

Institutional shareholders, which are mainly asset management companies focusing on long-term investment, often put pressure on the corporation to achieve corporate governance change, including but not limited to BlackRock, Argyle Street Management Limited (Argyle Street) and Passport. With a view to successfully launching an activist campaign, the institutional investors will normally identify and align with other minority shareholders and hedge funds. Hedge fund activists may also institute a campaign by themselves such as Elliott Management Corporation (Elliott).

5 What are the main operational governance and sociopolitical areas that shareholder activism focuses on? Do any factors tend to attract shareholder activist attention?

The focus of shareholder activism in Hong Kong is on making demands in relation to the major strategic transactions of the company, which is normally triggered by the underperformance of the corporation or a transaction that will unfairly prejudice the interests of minority shareholders. For instance, Elliott and Passport raised an activist campaign to oppose a placement agreement proposed by the investee listed company, whereas minority shareholders of Power Asset Holdings Limited (Power Asset) raised an activist campaign to oppose the proposed merger with Power Asset raised by Cheung Kong Infrastructure Holdings Limited. In 2016, BlackRock also urged the minority shareholders of G-Resources to vote against the company's sale of a gold mine at an undervalue since the sale price was unreasonably low and the proposal would completely alter the nature of business of G-Resources. The reasons behind these shareholder activist campaigns are the prejudicial effects caused to the interests of minority shareholders by management proposals.

Another focus of shareholder activism is a demand for a higher shareholder yield. On 19 October 2016, Mr David Webb, a well-known shareholder activist in Hong Kong, published an open letter demanding Ming Fai International Holdings Ltd to distribute a special dividend out of the proceeds of a proposed asset disposal. H Partners Management LLC also demanded Hong Kong Economic Times Holdings Ltd to distribute a special dividend through open letters published in newspapers dated 11 July 2011. In 2017, Argyle Street urged the board of CMS to distribute more dividends since the stocks had been undervalued.

Operational demand, such as a demand for a change to board composition and management structure, is less common in Hong Kong. For instance, the Children's Investment Fund Management (UK) LLP published various newspaper articles announcing its demand to remove the Chairman of Link REIT in 2006. The relatively small number of operational demands in Hong Kong is probably owing to the lack of the requirement of minimum board representation for minority shareholders in Hong Kong. Besides, almost all listed companies in Hong Kong only issue one class of shares and each share carries equal voting right.

Nevertheless, listed companies have now been allowed to issue dual-class shares since April 2018. It remains to be seen whether more operational demands will be raised by activists.

SHAREHOLDER ACTIVIST STRATEGIES

Strategies

6 What common strategies do activist shareholders use to pursue their objectives?

The common strategies adopted by activists may be divided into three non-mutually exclusive categories, namely, informal strategies, voting strategies and legal strategies.

Informal strategies comprise private engagement, public announcement, open letters or publications, and website campaign, with private engagement being the most common and preferred form. Preliminarily, activists will enter into a private dialogue and attend meetings with the company management to pursue their objectives and press for a change. Thereafter, activists may write to other shareholders detailing their proposals and persuade them to vote in favour of the proposals or resolution in private.

If private negotiations break down, activists may resort to public intervention. The activists may make a public announcement and publish an open letter stating their demands to draw the public's attention and exert pressure on the controlling shareholders. H Partners Management LLC wrote a public letter to HKET seeking support from other shareholders to vote in favour of its proposal for distributing special dividends. The letter was published in various newspapers on 11 July 2011. Publications are also another tactic adopted by shareholder activists such as BlackRock. BlackRock published 'Corporate governance and proxy voting guidelines for Hong Kong securities' in January 2019, in which it details its engagement approach, its expectation of the company improving its corporate governance, and voting policies.

Shareholder activists will also institute website campaigns and publish their demands against the company, such as:

- David Webb's demands against various listed corporations (https://webb-site.com/);
- Elliott's demand against BEA (https://fairdealforbea.com/); and
- Argyle Asset's open letters to CMB (https://unlockvaluecmb.com/author/brianlwh/).

Nevertheless, shareholder activists generally would not resort to website campaigns or public announcements unless there was sufficient evidence to substantiate a reasonably articulable suspicion.

Besides informal strategies, shareholder activists will also avail of the voting rights accorded to them under the Listing Rules and the Takeovers Code. For instance, Cheung Kong, a shareholder holding 38.87 per cent stake in Power Asset, proposed to merge with Power Asset. In this, 49.23 per cent of the independent minority shareholders exercised their veto right and successfully opposed the proposed merger.

If the activists do not receive a positive response after utilising the informal strategies, they may escalate their engagement activity and employ legal tactics, for instance, applying for an inspection order and an injunction order to exert pressure on the company and the management. Pursuant to section 740 of the Companies Ordinance, a shareholder holding at least 2.5 per cent of the voting rights at the general meeting or five shareholders collectively may apply to the court for an order inspecting any record or document of the company. The court shall satisfy itself that the inspection is for a proper purpose and in good faith before granting an inspection order. Nevertheless, an inspection order may be an essential but not effective legal strategy as

shown in Elliott's campaign against the private placement proposed by BEA. Elliott applied for an inspection order for documents relating to the private placement. Within one month of the application for an inspection order and before the grant of the order, the private placement was approved. Nevertheless, Elliott launched an action against the Bank of East Asia upon inspecting and obtaining the documents relating to the private placement. As at the time of writing, the litigation between Elliott and the Bank of East Asia is still ongoing.

An injunction order, as compared to an inspection order, would be a more effective and preferable legal tactic in the eyes of activists. Passport instituted a campaign against the private placement by eSun Holdings Ltd (eSun) and applied for an ex parte injunction order to prohibit eSun from proceeding with the private placement. The application succeeded and the proposed placement agreement was eventually terminated.

Besides interim legal measures, activists may also commence legal proceedings against the company, such as an unfair prejudice claim, shareholder derivative actions, and a winding-up petition. Interim measures aside, Passport and Elliott also filed an unfair prejudice claim with a view to terminating the placement agreement and releasing the shareholders from the obligation under the private placement agreement respectively.

Under section 724(1) of the Companies Ordinance, a shareholder of the company, including a non-Hong Kong company, may also bring an unfair prejudice action if the affairs of the company are being or have been conducted in a manner that is unfairly prejudicial to the interest of the members in general or one or more members. Another basis for a shareholder to bring the action is an actual or proposed act or omission of the company that is or would be prejudicial.

According to Mr Justice Fuad in *Re Taiwa Land Investment Co Ltd* [1981] HKLR297, 'unfairly prejudicial' means the conduct departing from accepted standards of fair play which amounts to unfair discrimination against the minority. The conduct complained of must be both unfair and prejudicial.

Examples of unfair prejudicial conduct include:

- breach of the Companies Ordinance (such as failure to obtain members' approval for non-pro rata allotment of shares: *Re a Co* (No. 005134 of 1986), *ex p Harries* [1989] BCLC 383);
- breach of the Listing Rules (for instance, the minority shareholders' effort in blocking the resolution to amend the articles of association of a listed company when the provisions therein contravened the Listing Rules: *Luck Continent Ltd v Cheng Chee Tock Theodore* [2013] 4 HKLRD 181);
- breach of shareholders' agreement (*Re Bondwood Development Ltd* [1990] 1 HKLR 200);
- breach of fiduciary duties (such as misappropriation of company assets: *Re Tai Lap Investment Co Ltd* [1999] 1 HKLRD 384); and
- long-term policy of not paying dividends or paying low dividends without commercial reasons (*Choi Chi Wai v Cheng Ka Shing* [2017] HKEC 850).

The remedies for a successful unfair prejudice claim include:

- an order restraining the continuance of the unfair prejudicial conduct of the company (section 725(2)(a)(i) of the Companies Ordinance);
- an order regulating the conduct of the company's affairs in future (section 725(2)(a)(iv)(A) of the Companies Ordinance);
- an order to purchase the shares of any member of the company by the company or another member of the company (sections 725(2)(a)(iv)(A) and 725(2)(a)(iv)(B) of the Companies Ordinance);
- an order to pay damages by the company or any other person (section 725(2)(b) of the Companies Ordinance);
- an appointment of receiver or manager (section 725(3) of the Companies Ordinance);
- an order for alteration of a company's articles (*Roberts v Walter Developments Pty Ltd* (No.2) (1992) 10 ACLC 804); and
- any other orders the court thinks fit (section 725(2)(a)(iv)(D) of the Companies Ordinance).

Further, or in the alternative to an unfair prejudice claim, shareholders may also apply for a winding-up of a Hong Kong company on just and equitable grounds pursuant to section 177(1)(f) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Companies Ordinance (Winding up)). A winding-up order of foreign companies, including non-Hong Kong companies, on just and equitable grounds shall be sought under section 327(3)(c) of the Companies Ordinance (Winding Up). The Securities and Futures Commission (SFC) may also wind up a listed company under section 212 of the SFO to protect the company's minority shareholders if it is in the public interest to do so, namely, the winding-up order is in line with the objectives and functions of the SFC as set out in sections 4 and 5 of the SFO. For instance, in *Re China Metal Recycling (Holdings) Ltd* [2015] 2 HKLRD 747, the respondent company, which had disseminated fraudulent information in its prospectus, was ordered to be wound up upon the SFC's application in 2015.

Examples of just and equitable grounds include:

- mutual breakdown of trust and confidence (*Re Yung Kee Holdings Ltd* (2015) 18 HKCFAR 501, in which there is a breach of common understanding that two sons of the original controller of the company shall operate the company together); and
- frustration of the company's objects (*Re Mediavision Ltd* [1993] 2 HKC 629, in which there is final and conclusive abandonment of the original business of the company).

Nevertheless, the winding-up application should not be made as a matter of course where there is also an unfair prejudice claim made by the shareholders (*Re Sun Light Elastic Ltd* [2013] 5 HKLRD 1). Shareholders must particularise why a winding-up order is an appropriate relief for the unfair prejudice claim.

The above case laws relating to unfair prejudice and winding-up on just and equitable grounds largely concern private limited companies. However, as a matter of general principle, they should be equally applicable to listed companies, the fact that a listed corporation may have a large number of shareholders involved and the fact that the corporation is also subject to the regulation of the HKEx may introduce a certain degree of uncertainty as to the extent to which these principles are applicable to listed corporations.

For instance, while a breach of the Companies Ordinance may be considered to be unfairly prejudicial conduct, a mere breach of the Listing Rules by a listed company would not automatically give rise to unfair prejudice (*Re Astec (BSR) plc* [1998] 2 BCLC 556). However, in the context of a listed company (as opposed to a private company), it was held that there was a common understanding among the shareholders that the company should maintain its listing status and, therefore, conduct jeopardising the listing status of the company could amount to unfair prejudice (*Luck Continent Ltd v Cheng Chee Tock Theodore* [2013] 4 HKLRD 181). Nonetheless, according to *Re Blue Arrow Plc* [1987] 3 BCC 618 (Ch), any breach of any informal understanding that is said to supplement a listed company's articles of association is unlikely to be regarded as an unfair prejudice since the investing public is entitled to assume that the company's articles are full and complete and there is no private agreement reached in relation to the articles.

Regardless of which strategies shareholder activists adopt, they will increase their stakes in the company simultaneously to exert further pressure on the investee companies. Should the campaign raised by the activists fail, they will usually sell their stake in the company to minimise loss.

Processes and guidelines

7 | What are the general processes and guidelines for shareholders' proposals?

First, shareholders should identify the nature of their demand, namely whether they are demanding distribution of dividends, a change to board composition and governance structure, a change to the business model, or termination of a proposed transaction.

Second, shareholders should familiarise themselves with the requirements for convening a general meeting. Pursuant to section 566 of the Companies Ordinance, 5 per cent of the total voting rights of all members having a right to vote at general meetings could request the board of directors to hold a general meeting and that request could be made in hardcopy or electronic form. The content of the request shall specify the general nature of the business to be dealt with at the meeting and may include the text of a resolution intended to be moved at the meeting.

Directors must convene a general meeting within 21 days of receipt of the request and the meeting must take place within 28 days of the notice convening the meeting pursuant to section 567 of the Companies Ordinance. If the directors fail to do so, the members who requested the general meeting, or any of them representing more than half of the voting rights of all of them, may themselves convene a meeting at the company's expense according to section 568(1) of the Companies Ordinance.

Annual general meetings (AGM) shall instead be convened by directors. In default, shareholders of the company may apply to the court for an order calling an AGM according to section 610(7) of the Companies Ordinance. Unlike extraordinary general meetings (EGM), there is no provision for a specified number of shareholders to requisition an AGM.

Third, notice of general meetings shall be sent by the company to its shareholders in hardcopy or electronic form. The length of notice for AGMs and EGMs are 21 clear days and 14 clear days respectively according to section 571 of the Companies Ordinance. Subject to the provisions in the articles of association, the length of notice is the same regardless of whether the resolutions to be passed in the AGM are ordinary or special.

If shareholders are unclear about the procedure to nominate a candidate for election as a director, they may refer to the procedures published by the subject Hong Kong-listed company on its website. The listed company will be in contravention of Rule 13.51D of the Listing Rule if it fails to do so.

Fourth, shareholders should satisfy the threshold required for passing their proposed resolution (namely ordinary resolution or special resolution), which is normally stated in the Companies Ordinance and the company's articles. Each company is free to draft its own customised set of articles and set a different threshold for different resolutions. Assuming the investee company follows model articles of association for public companies limited by shares (the model articles), the following can only be resolved by a special resolution (namely a majority of at least 75 per cent):

- directions by the shareholders to take or refrain from doing certain acts (articles 3 and 4 of the model articles);
- reduction of share capital (section 226(1) of the Companies Ordinance); and
- alteration of object clause (section 89 of the Companies Ordinance).

On the contrary, some subjects can be resolved by an ordinary resolution (namely a majority of at least 50 per cent), such as the appointment of a director (article 23 of the model articles).

If the shareholders' demands relate to distribution of dividends, regardless of interim or final, shareholders shall be bound by the maximum limit of the amount of dividends recommended by the directors according to article 91 of the model articles.

If the shareholders challenge certain transactions proposed by the company or the majority shareholders, they should identify whether the proposed transaction is subject to shareholders' approval. Pursuant to the Listing Rules, certain transactions require approval from shareholders such as:

- connected transaction (Rules 14A.03 and 4A.36);
- major acquisition or disposal transaction (Rules 14.33(2); 14.40 and14.44);
- very substantial acquisition or disposal transaction (Rules 14.33(2), 14.44 and 14.49); and
- reverse takeovers (Rules 14.33(2),14.44 and 14.55).

Furthermore, certain transactions specifically required the approval of minority shareholders according to the Listing Rules, such as:

- right issues or open offers (Rules 7.19A(1) and 7.27A); and
- open offers (Rules 7.24A(1) and 7.27A).

According to Rules 2.15 and 14.33 of the Listing Rule, when a transaction or arrangement proposed by the listed company is subject to shareholders' approval, shareholders having a material interest and close associates must abstain from voting.

8 | May shareholders nominate directors for election to the board and use the company's proxy or shareholder circular infrastructure, at the company's expense, to do so?

Shareholders are entitled to nominate a candidate to stand for election as a director. Assuming the company adopts the model articles, shareholders may require a shareholder meeting to be convened or a resolution to appoint a director to be tabled at the meeting. If the director fails to convene a general meeting, a shareholder may do so at the company's expense. Moreover, according to article 24(10) of the model articles, a shareholder shall send the company a notice of his or her intention to propose the person to be appointed as a director and that person shall also send the company a notice of his or her wish to be appointed at least seven days before the general meeting.

According to Rule 13.70 of the Listing Rules, if a notice is received from a shareholder's proposal for nominating directors for election after the publication of the notice of meeting, the listed company shall publish an announcement or issue a supplementary circular, in which particulars of the proposed director shall be included.

Shareholders representing at least 2.5 per cent of the total voting rights or at least 50 members who have a right to vote at the general meetings are empowered to request for:

- circulation of the resolution proposed by them for the AGM at the company's expense provided that such request is sent to the company not later than six weeks before the AGM or the time at which notice of that meeting is given (sections 615 and 616 of the Companies Ordinance); and
- circulation of statement relating to a matter mentioned in a proposed resolution and other business to be dealt with at the general meetings (sections 580 and 581 of the Companies Ordinance). The costs of circulation of the statement on extraordinary general meetings shall be governed by the company's articles. In the absence of such provisions in the articles, the members who made the request for circulation shall bear the expenses (section 582 of the Companies Ordinance). On the contrary, the cost for the circulation of statement in relation to an AGM shall be borne by the company if the requests are received by the company in time so that the company could send a copy of the same together with the notice of the general meeting (section 582 of the Companies Ordinance).

If shareholders are unclear about the procedure to nominate a candidate for election as a director, they may refer to the procedures published by the subject Hong Kong-listed company on its website. Rule 13.51D of the Listing Rule obliges all listed companies to publish the procedures.

9 | May shareholders call a special shareholders' meeting? What are the requirements? May shareholders act by written consent in lieu of a meeting?

In Hong Kong, special general meeting of the shareholders is also known as an extraordinary general meeting or special shareholders' meeting. Regarding Hong Kong incorporated companies, 5 per cent of the total voting rights of all the members having a right to vote at the general meeting have a statutory right to request an extraordinary general meeting according to section 566 of the Companies Ordinance.

Litigation

10 | What are the main types of litigation shareholders in your jurisdiction may initiate against corporations and directors? May shareholders bring derivative actions on behalf of the corporation or class actions on behalf of all shareholders? Are there methods of obtaining access to company information?

The main types of litigation shareholders may institute against corporations and directors are statutory derivative actions and claims for unfair prejudice.

In Hong Kong, shareholders have a statutory right to bring a derivative action for and on behalf of a Hong Kong company, a non-Hong Kong company and an associated company of the company, in respect of misconduct committed against the corporation according to sections 731 and 732 of the Companies Ordinance. It is, however, not appropriate for an individual shareholder to take a derivative action if he or she has a personal grievance against the company and if the wrong complained of was not done to the company.

Misconduct is defined as 'fraud, negligence, breach of duty, or default in compliance with any Ordinance or rule of law' under section 731 of the Companies Ordinance. In Hong Kong, the usual reasons for bringing a derivative action are:

- a fraudulent, oppressive or ultra vires act (*Anglo-Eastern (1985) Ltd v Karl Knutz* [1988] 1 HKLR 322, [1987] 3 HKC 80, CA);
- acts not authorised by the company's articles (section 116(3) of the Companies Ordinance);
- a criminal act (*Cockburn v Newbridge Sanitary Steam Laundry Co Ltd and Llewellyn* [1915] 1 IR 237);
- the majority of the votes being controlled by wrongdoers (*Smith v Croft* (No 2) [1988] Ch 114, [1987] 3 All ER 909); and
- a resolution not being passed by the required threshold (*Baillie v Oriental Telephone and Electric Co Ltd* [1915] 1 Ch 503).

Prior to bringing a statutory derivative action, shareholders should first obtain leave from court and the court will consider the following factors stated in section 733 of the Companies Ordinance before making a decision:

- whether the proposed action appears to be in the company's interests;
- whether there is a serious question to be tried and the company has not itself brought the proceedings;
- whether the member has served written notice on the company 14 days prior to the application for leave; and
- whether the plaintiff has already commenced any common law derivative action on the same subject matter.

Shareholders also have a common law right to bring a multiple derivative action on behalf of the corporation in respect of the wrongdoer's fraudulent act according to *Waddington Limited v Chan Chun Hoo Thomas and others* (2008) 11 HKCFAR 370. While the statutory derivative action does not displace the right to bring a common law derivative action, two derivatives actions are mutually exclusive. The statutory derivative action is more prevalent.

The possible defences to derivative actions are, first, that the nature of the subject act is not 'misconduct' for the purposes of section 732 of the Companies Ordinance. Second, the company may also raise the plaintiff's conduct as a defence if that conduct would make it inequitable for it to bring such an action. Third, the company may also rebut the derivative action on the ground that it is acting properly within its powers.

The remedies in statutory derivative actions are set out in sections 737(1)(2) of the Companies Ordinance, which include:

- an interim order pending the determination of the derivative action;
- an order directing the company or its officer to provide or not to provide information, or to do or not to do any act; and
- an order appointing an independent person to conduct an investigation and report to the court.

Shareholders cannot commence class actions on behalf of all shareholders since there is no class action regime in Hong Kong at this juncture. Nevertheless, the SFC indicated in the Consultation Conclusions on the Principles of Responsible Ownership published in March 2016 that it will consider the introduction of class action rights in the future and when appropriate.

Shareholders can gain access to company information online free of charge. Rule 13.90 of the Listing Rule requires the listed companies to publish their announcements and their up-to-date by-laws on the Exchange's website (http://www3.hkexnews.hk/listedco/listconews/advancedsearch/search_active_main.aspx) and its own website.

In addition to the online public information, shareholders holding at least 2.5 per cent of the voting rights at the general meeting or five shareholders collectively are entitled to apply to the court to inspect any record or document of the company pursuant to section 740 of the Companies Ordinance. Moreover, under section 631 of the Companies Ordinance, shareholders may make a request for inspection of the Register of Members free of charge and for inspection of any other register, index, agreement, minutes or other documents that a company is required to keep, such as a register of charges, upon the payment of HK$50 as an inspection fee.

SHAREHOLDERS' DUTIES

Fiduciary duties

11 | Do shareholder activists owe fiduciary duties to the company?

Shareholders in Hong Kong, regardless of whether they are a majority, minority or significant shareholder, do not owe a fiduciary duty to the company. Instead, the directors owe a fiduciary duty to the company.

Compensation

12 | May directors accept compensation from shareholders who appoint them?

Directors shall not accept direct compensation from shareholders who nominate them if there is a conflict of interest. Directors owe a fiduciary duty to the company and must act in good faith in the interests of the company as a whole. A director also must not make any secret profits in relation to his fiduciary capacity to the company. Accepting such direct

compensation is likely to be regarded as a breach of fiduciary duty. Upon the finding of a breach of fiduciary duty, the court may order a wide range of remedies including an injunction, damages and declaring that the contract is void or voidable, according to sections 728(4) and 729 of the Companies Ordinance.

Moreover, according to sections B.1.2 and B.1.2(c) of the CG Code, no director should be involved in deciding his or her own remuneration. Director's salary shall be determined by the remuneration committee. It is, therefore, unlikely that the directors shall accept direct compensation from shareholders who nominate them.

Mandatory bids

13 | Are shareholders acting in concert subject to any mandatory bid requirements in your jurisdiction? When are shareholders deemed to be acting in concert?

First, 'acting in concert' is defined under the Takeovers Code as 'persons who, pursuant to an agreement or understanding (whether formal or informal), cooperate, to obtain or consolidate control of a company or to frustrate the successful outcome of an offer for a company'. Unless the contrary is established, certain classes of persons or corporations are presumed to be acting in concert with others in the same class, including but not limited to its parent company, its subsidiaries, its directors, and its financial or professional advisers. The Takeovers Panel will consider all circumstances when deciding whether parties are acting in concert.

While activists may solicit support from other minority shareholders of the company on a particular resolution, for instance a change to board composition, such act will not generally render activists acting in concert with other minority shareholders. This is because Rule 26.1 Notes 4 of the Takeovers Code explicitly provides that shareholders voting together on a particular resolution would not lead to an offer obligation, although that circumstance may be taken into account as one indication that the shareholders are acting in concert.

The mandatory bid requirement is contained in Rule 26 of the Takeovers Code, which provides that a person and his or her concerted parties acquiring 30 per cent or more voting rights of a company is required to make a general offer to all shareholders of the company unless a waiver is granted. Any additional purchase of 2 per cent voting rights shall also be subject to the mandatory offer obligation.

Nevertheless, according to Rule 26.2 of the Takeovers Code, a mandatory offer must be conditional on the offeror receiving over 50 per cent of the voting rights. If the offeror holds more than 50 per cent of the voting rights before the general offer is made, the offer must normally be unconditional.

According to Rule 8.3 of the Takeovers Code, the mandatory general offer document must contain information required by Schedule I to the Takeovers Code, particularly the details of the identity of any concert parties, the interests in securities held by the offeror in the target company, together with any other information that will enable shareholders of the target company to make an informed decision.

Disclosure rules

14 | Must shareholders disclose significant shareholdings? If so, when? Must such disclosure include the shareholder's intentions?

Shareholders in Hong Kong must disclose significant shareholdings. Persons holding a 5 per cent or more interest in a Hong Kong listed company shall notify the Exchange and the subject listed company pursuant to sections 310(1), 311, 313 and 315 of the SFO. An initial notification shall be made within three business days of the date of acquiring 5 per cent or more voting rights or the date when that person was aware of its occurrence (whichever is later). If the voting share capital held by that person falls below 5 per cent or increases, subsequent notifications shall be made within 10 days of its occurrence.

To comply with the duty of disclosure, shareholders must complete and submit the Disclosure of Interest forms (DI forms) to the Exchange through the Disclosure of Interest Online System (DION System). Notification by hand, post, fax or email is no longer accepted. The DI forms can be downloaded at the Exchange news website.

After receiving the notification from the shareholders, the listed company shall record the interest in the shares and the name of the shareholder in the register pursuant to section 336 of the SFO.

If a shareholder fails to make a disclosure within the time limit stipulated in the SFO or makes a false or misleading statement, he or she shall be penalised and may be subject to a maximum fine of HK$100,000 or a maximum prison sentence of two years for each offence pursuant to section 328 of the SFO.

15 | Do the disclosure requirements apply to derivative instruments, acting in concert or short positions?

Shareholders in Hong Kong must disclose significant shareholdings. Persons holding 5 per cent or more interest in a Hong Kong listed company shall notify the Exchange and the subject listed company pursuant to sections 310(1), 311, 313 and 315 of the SFO. An initial notification shall be made within three business days of the date of acquiring 5 per cent or more voting rights or the date when such person was aware of its occurrence (whichever is later). If voting share capital held by such person falls below 5 per cent or increases, subsequent notifications shall be made within 10 days of its occurrence.

To comply with the duty of disclosure, shareholders must complete and submit the Disclosure of Interest forms (DI forms) to the Exchange through the Disclosure of Interest Online System (DION System). Notification by hand, post, fax or email is longer accepted. The DI forms could be downloaded at the Exchange news website.

After receiving the notification from the shareholders, the listed company shall record the interest in the shares and the name of the shareholder in the register pursuant to section 336 of the SFO.

If a shareholder fails to make a disclosure within the time limit stipulated in the SFO or makes a false or misleading statement, he or she shall be penalised and may subject to a maximum fine of HK$100,000 or a maximum prison sentence of two years for each offence pursuant to section 328 of the SFO.

Insider trading

16 | Do insider trading rules apply to activist activity?

Insider dealing rules and the Securities and Futures Ordinance do apply to activist activity.

COMPANY RESPONSE STRATEGIES

Fiduciary duties

17 | What are the fiduciary duties of directors in the context of an activist proposal? Is there a different standard for considering an activist proposal compared to other board decisions?

In particular, when considering all resolutions and proposals tabled in front of directors (whether they are an activist proposal or not), directors must act in good faith in the interests of the company, must exercise their powers for proper purposes, must not enter into ultra vires transactions and must avoid conflicts of interest.

It is not mandatory for directors to consider an activist proposal. The standard for considering an activist proposal is the same as other

board decisions, namely reasonable care, skill and diligence (section 465 of the Companies Ordinance and Rule 3.08 of the Listing Rule). 'Reasonable care, skill and diligence' means the general knowledge and experience that is actually possessed by the director and that may reasonably be expected of a person carrying out a director's functions.

Preparation

18 | What advice do you give companies to prepare for shareholder activism? Is shareholder activism and engagement a matter of heightened concern in the boardroom?

It is strongly suggested that the company shall follow the CG Code, in particular sections D.3 and E, to minimise the risk of facing shareholder activism.

The company may routinely review its shareholder engagement policy and regularly solicit feedback from shareholders on its corporate strategy and governance. A corporate governance guideline setting out the routes for shareholders to provide feedback on its business operation could also be published for the sake of clarity.

A company may also enhance its transparency in its corporate decisions and management structure by publishing the guidelines or code of business conduct followed by the company. As such, the activists will gain access to more information as to the company's decision-making processes and will take this information into account prior to instituting an activist campaign.

Regular strategic reviews should also be conducted. Companies should regularly evaluate and compare performance, cost structure, revenue, management structure, and the independence and expertise of directors, with their counterparts to discourage activist campaigns due to the company's underperformance.

Unusual trading of stock should also be closely monitored since the larger the stake held by shareholders, the more likely that they will become shareholder activists and exercise their minority veto rights.

Companies should be open-minded towards an activist's proposal and step into the shoes of an activist. A unilateral decision to ignore an activist may provoke the activist to raise a campaign. An individual committee could be formed to analyse the activist's proposal.

Nevertheless, these are only general principles that the company may follow and are subject to the factual situation in each case.

Defences

19 | What defences are available to companies to avoid being the target of shareholder activism or respond to shareholder activism?

Some jurisdictions allow a dual-class shareholding structure, in which a particular class of share carries more voting rights than another. While Hong Kong also allows listed applicants with a weighted voting right structure that satisfies the requirements stated in Rule 8A.06 in the Listing Rule to apply for listing, the companies that have already listed in Hong Kong are not allowed to adopt a weighted voting right structure at this juncture according to Rule 8A.05 of the Listing Rule.

Certain procedural safeguards are already in place for the company. Assuming the company has adopted the model article, under article 2 therein, the business and affairs of the company are managed by the directors (but not shareholders), who may exercise all powers of the company. Rule 3.08 of the Listing Rule also reflects the rule that it is the board, not the shareholders, who are responsible for the management and the operation of the company. The Hong Kong court shall intervene only when the boundaries of discretion are transgressed.

If shareholders would like to reallocate power between general meeting and the board, they may take preventive measure to amend the articles of the company. When customising its own articles, companies may or may not grant powers to the directors, subject to the control of the shareholders, via a decision achieved by a certain level of majority (eg, by an ordinary resolution). Nevertheless, the alteration of the articles of association shall not be unfairly prejudicial to the minority or in contravention of the Companies Ordinance. Each case is fact-sensitive and whether the alteration amounts to an unfair prejudice depends on the nature and degree of benefit to the company.

The resolution to alter its articles may only be passed by special resolution. As such, companies shall take prompt action before an activist together with its alliance accumulate a total shareholding of 25 per cent.

However, even if the resolution to amend the articles is blocked by a minority shareholder holding more than 25 per cent interest, the majority shareholder may bring a claim for unfair prejudice if the articles violate the provisions in the Listing Rules. For instance, in *Luck Continent Ltd v Cheng Chee Tock Theodore* [2012] HKEC 567, the majority shareholder of Luck Continent Ltd successfully applied to the court for an order of amending the articles based on an unfair prejudice claim. This is because the articles of association requires a special resolution for the removal of director, which is in contravention of the threshold stated in the Listing Rules, namely ordinary resolution, but the minority shareholder repeatedly exercised its minority veto right to block the resolution for alteration of such provisions in the article.

Proxy votes

20 | Do companies receive daily or periodic reports of proxy votes during the voting period?

A proxy form offering two-way voting on all resolutions must be sent together with the notice of general meeting to the shareholders and must be submitted for publication on the Exchange's website according to Rule 13.38 of the Listing Rule. The time and place for lodging proxy forms shall be stated in the proxy form. It is a common practice in Hong Kong for shareholders to lodge a proxy form with the share registrar of a listed company. As such, whether the companies receive daily or periodic reports of proxy votes during the voting period depends on the common practice of different share registrars in Hong Kong and the agreement entered into between the listed company and its share registrar.

Nevertheless, SFC imposes an obligation on all share registrars to ensure all communications between the listed company and its registered shareholders that the share registrar is instructed to distribute, are distributed in a timely, accurate and appropriate manner in accordance with paragraph 5.5 of the Code of Conduct for Share Registrar.

Settlements

21 | Is it common for companies in your jurisdiction to enter into a private settlement with activists? If so, what types of arrangements are typically agreed?

It is common for companies in Hong Kong to enter into a private settlement with activists and the types of arrangement commonly agreed between the parties include:

- agreement to appoint shareholder activist's designee to the board of the directors;
- agreement to change the corporate governance of the company, such as modifying the size and composition of the board of directors of the company;
- agreement not to enter into certain transactions; and
- non-disparagement agreement.

SHAREHOLDER COMMUNICATION AND ENGAGEMENT

Shareholder engagement

22 | Is it common to have organised shareholder engagement efforts as a matter of course? What do outreach efforts typically entail?

It is more common to have organised shareholder engagement efforts since the CG Code expressly recommends that listed companies have an ongoing dialogue with shareholders to communicate with them and encourage their participation. Also, the CG Code suggests that listed companies shall formulate a shareholders' communications policy. Many Hong Kong-listed companies have carried out shareholder engagement as a matter of course and complied with the shareholder engagement efforts requirement stated in the CG Code. Around 70 per cent of the Hong Kong companies also indicate that the board's shareholder communications strategies do not differ for different types of shareholders.

The outreach efforts typically entail:

- regular participation in investor conferences and roadshows (for example, MTR held over 370 meetings with institutional investors and research analysts in Hong Kong and elsewhere during 2017);
- seminars and workshops for investors and industry associations;
- a specific hotline or email (or both) answering enquiries from individual shareholders; and
- regular dissemination of the company's information to shareholders through email and websites.

23 | Are directors commonly involved in shareholder engagement efforts?

Directors are expected to be commonly involved in shareholder engagement efforts in Hong Kong. According to section A.2.8 of the CG Code, the chairman should ensure that appropriate measures have been taken to provide effective communication with shareholders and their views are communicated to the board of directors as a whole. In the general meetings, the chairman of the board is expected to be present and answer shareholders' queries. As recommended in sections E.1 and E.1.4 of the CG Code, the board of the listed corporation shall bear the duty to maintain an ongoing dialogue with shareholder by, inter alia, communicating with shareholders in general meetings, and shall establish shareholders' communication policy.

Section O of the CG Code also provides that, the company must disclose the procedures by which enquiries may be put to the board and sufficient contact details to enable these enquiries to be properly directed to the board in its Corporate Governance Report. The company shall also list out the procedures and sufficient contact details therein for shareholders putting forward proposals at shareholders' meetings. As such, directors are likely to be commonly involved in shareholder engagement efforts.

Disclosure

24 | Must companies disclose shareholder engagement efforts or how shareholders may communicate directly with the board? Must companies avoid selective or unequal disclosure? When companies disclose shareholder engagement efforts, what form does the disclosure take?

With a view to promoting shareholders engagement, a listed company is required to disclose the following information in its Corporate Governance Report according to Paragraph O of the CG Code:

- the way in which shareholders can convene an extraordinary general meeting;
- the procedure for sending enquiries to the board with sufficient contact details; and
- the procedure for making proposals at shareholders' meeting with sufficient contact details.

As such, shareholders may refer to the company's Corporate Governance Report and communicate directly with the board through the contact method indicated therein.

The board of directors shall also establish a shareholders' communication policy and review it on a regular basis to ensure its effectiveness according to section E.1.4 of the CG Code. It is mandatory for the listed company to disclose whether these have been done in their interim reports and annual reports. If there is any deviation from the sections of the CG code, reasons shall be provided in the annual return.

Nevertheless, companies shall avoid selective disclosure. While it is understandable that where an activist has entered into dialogue with the board of the company and certain information shall be disclosed by the company to the activist, such information may fall under the scope of 'inside information' under section 307A(1) of the SFO especially if other shareholders are not provided with such information. As such, any further dealing by the activist in the company's shares may amount to an act of insider dealing pursuant to sections 270(1)(e) and 291(5) of the Securities and Futures Ordinance (SFO). In this regard, companies shall endeavour to avoid selective disclosure.

Communication with shareholders

25 | What are the primary rules relating to communications to obtain support from other shareholders? How do companies solicit votes from shareholders? Are there systems enabling the company to identify or facilitating direct communication with its shareholders?

Unless a shareholder disagrees, documents and information could be sent by the company to its shareholders in electronic form according to section 831 of the Companies Ordinance and Rule 2.07A of the Listing Rules. Further, according to sections 833 and 573 of the Companies Ordinance, the company may communicate with its shareholder and publish the notice of general meeting on its website if the Articles expressly permitted it to do so and the shareholders agree to it.

According to Rule 13.39(4) of the Listing Rules and section E.1.2 of the CG Code, the companies must solicit votes from shareholders at a general meeting by poll unless the chairman decides to allow a resolution relating to a purely procedural or administrative matter to be voted by a show of hands. The listed company must also announce the meeting's poll results as soon as possible but, in any event, at least 30 minutes before the earlier of either the commencement of the Exchange's morning trading session or any pre-opening session on the business day after the general meeting.

Regarding the method to solicit support from other shareholders, open letter is a common tool in Hong Kong. Nevertheless, there is an inherent risk in publishing an open letter. If the open letter contains any false or misleading information about securities or futures that is likely to induce investment decisions or have an impact on the price and the activists knowingly, recklessly or negligently disseminate the false and misleading information, activists may be held liable under sections 277 and 298 of the SFO to pay compensation to those who have suffered as a result of the wrongful information.

For instance, Andrew Left of Citron Research was found criminally liable by the Court of Appeal under section 277 for his false allegation in his research report that Evergrande Real Estate Group Limited (Evergrande) was insolvent and had consistently presented fraudulent information to the public. The share price of Evergrande fell sharply on the same day following the publication of the report. As such, Andrew

Left was banned from trading for five years and ordered to disgorge his profit of HK$1,596,240 from shorting shares of Evergrande and to pay SFC investigation and legal costs.

The Court of Appeal specifically indicates that, when considering whether an unlicensed individual, namely Andrew Left, negligently disseminated the false and misleading information, the standard of care should be one that is comparable to a market commentator or analyst. Section 277 of the SFO creates a duty of care on any and all persons who choose to disseminate information that is likely to impact on the market with a view to maintaining the integrity of the market and protecting the investing public. In view of the above, both individual activists and institutional activists should carry out reasonable steps to ensure that the information in relation to their investee company is true and not misleading before the publication of such information.

Access to the share register

26 Must companies, generally or at a shareholder's request, provide a list of registered shareholders or a list of beneficial ownership, or submit to their shareholders information prepared by a requesting shareholder? How may this request be resisted?

According to section 366 of the SFO, all listed companies shall keep and allow shareholders to inspect the register of interests in shares (including both registered interests or beneficial interests) and record any change therein with a view to enabling members of the public to ascertain the identity and the particulars of persons who are the true owners of voting shares in the listed corporation.

Under section 340 of the SFO, any shareholder and the investing public may inspect the register for free and upon payment of HK$10 respectively. Shareholders and the investing public may also require a copy of the register of interests in shares and short positions upon payment. If the inspection request is rejected, the court of first instance may order and compel an immediate inspection of it.

Under section 329 of the SFO, listed corporations are empowered to investigate the beneficial ownership of interests in its voting shares and the persons subject to investigation are obliged to give particulars of the beneficial ownership of interests. Upon receiving the particulars as to the beneficial ownership, the listed corporation shall notify the Exchange of the same in accordance with section 330 of the SFO.

If a listed corporation does not proactively investigate the beneficial ownership of its shares, shareholders may request the company to do so under section 331 of the SFO and failing which the listed company will commit an offence and liable to a fine.

UPDATE AND TRENDS

Recent activist campaigns

27 Discuss any noteworthy recent, high-profile shareholder activist campaigns in your jurisdiction. What are the current hot topics in shareholder activism and engagement?

The current hot topic in shareholder activism is the public letter from Noster Capital LLP (Noster) to Tsui Wah Holdings Limited (Tsui Wah) in which Noster alleged that Tsui Wah has been mismanaged and the funds of the company have been misused. Noster, therefore, requested Tsui Wah to repurchase its share.

Another current hot topic in shareholder activism is that Blackrock Investment Stewardship has engaged with a listed company to better understand the involvement and contribution by independent directors in fulfilling the board's responsibility and to express its concern relating to the 10-year tenure for all the company's three independent directors. Recently, the Securities and Futures Commission and the HKEX emphasised the role of independent non-executive directors in improving corporate governance and preserving Hong Kong's reputation as a premiere capital-raising centre. According to section A.4.3 of the CG Code, serving more than nine years could be relevant to the determination of a non-executive director's independence.

Other recent hot topics in shareholder activism include the following two recent high-profile shareholder activist campaigns instituted by Elliott.

The primary aim of Elliott's campaign is to oppose a placement agreement proposed by the Bank of East Asia. Elliott filed an unfair prejudice petition against the Bank of East Asia on 18 July 2016 (*Elliott International LP v Bank of East Asia Ltd* (No. 2) (HCMP 1812/2016) and successfully sought an order for discovery of documents in relation to the private placement on 28 August 2018. The trial regarding the unfair prejudice petition has been fixed for 40 days commencing on 4 May 2020.

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